
IN THE
Supreme Court of the United States

OCTOBER TERM, 1941.

No. 913.

AMERICAN CHICLE COMPANY, *Petitioner*,

v.

THE UNITED STATES.

On a Writ of Certiorari to the United States
Court of Claims.

REPLY MEMORANDUM FOR THE PETITIONER.

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In view of the shortness of time available for oral argument this memorandum has been prepared for the possible convenience of the Court, to present answers to certain of the arguments in the Government's brief which it may not be possible to develop at the argument.

1. The Government concedes (Br. 13) that its formula eliminates from the computation the term "accumulated profits," which Congress introduced into the 1921 statute,

and took pains to define. But the Government says that this is "quite irrelevant." (Br. 13.) It says that the purpose of the change to "accumulated profits" was to make the credit available for taxes paid on profits earned in previous years.

Congress undoubtedly had that purpose, but if that had been the only purpose, it could have been done far more simply than it was, and without any change of the denominator of the fraction to "accumulated profits." The Government refers to the method followed by Congress as "simpler and clearer." (Br. 14, last sentence of note.) But, manifestly, the method followed by Congress was not the simple and clear way to reach the formula for which the Government now contends. Section 240(c) of the 1918 Act could very easily have been changed to produce the Government's formula without using the term "accumulated profits." All that was necessary to do was to amend section 240(c) by striking out the two phrases included below in brackets, as follows:

"For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits and excess-profits taxes paid [(but not including taxes accrued)] by such foreign corporation [during the taxable year] to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid."

Congress might also have changed the proviso so as to limit the credit in the way in which it was done in the 1921 Act. But we think it clear that with the omissions indicated

in the above quoted language, section 240 (c) would have accomplished the precise result in the computation of the foreign tax deemed to have been paid by the parent which the Government says is prescribed by the changed language of the 1921 Act. Thus it follows that the Government's argument that the reference to "accumulated profits" was introduced to achieve this result is not sound; and there is no reason for disregarding the important change made by Congress in the denominator of the fraction, and for saying that it is "irrelevant."

We may apply the same method to section 238 (e) of the 1921 Act. To achieve the results for which the Government contends, it is only necessary to strike out the words "accumulated profits" wherever they appear in that section, and to substitute therefor the words "gains, profits, or income," and to omit also the definition of term "accumulated profits." This is indicated in the following reprint of section 238 (e) (matter in brackets to be omitted; matter in italics to be substituted):

"For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the [accumulated profits] *gains, profits or income* of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such [accumulated profits] *gains, profits or income*: Provided, That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. [The term 'accumulated profits' when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits,

and excess-profits taxes imposed upon or with respect to such profits or income; and] the Commissioner with the approval of the Secretary shall have full power to determine from the [accumulated profits] *gains, profits or income* of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the [accumulated profits] *gains, profits or income* of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recent[ly accumulated] *gains, profits, or earnings.*"

The foregoing modification of section 238(e) seems to be a word for word demonstration of the statement in our brief and in the opinion of the Circuit Court of Appeals for the Third Circuit in *Aluminum Company of America v. United States*, 123 F. (2d) 615, 619, that the Government's construction of section 238(e) reads the term "accumulated profits" completely out of the statute, and restores the computation of the tax deemed to have been paid by the parent to the terminology of the 1918 Act.

2. The Government says (Br. 14) that it need not embark upon a study of the distinction between the words "upon" and "with respect to." This is apparently because the Government, throughout its brief, chooses to ignore completely the words "or with respect to." We pointed out at p. 26 of our main brief that the Government's argument turns upon this ignoring of the words used by Congress. The Government simply construes the phrase "upon or with respect to" to mean "on." Its argument throughout is as if Congress had prescribed the credit as a fraction of the taxes paid *on* the accumulated profits. This is nicely shown at the top of page 20 of the Government's brief, where the statute is actually *misquoted* in this way. It is set out as "on such profits or income," although the statute actually reads "upon or with respect to such profits or income." Section 131(f), definition of "accumulated profits." We do not doubt that this misquotation was inadver-

tent, and we would not mention it except for the fact that it seems to illustrate completely the state of mind on which the Government's argument rests. When that sentence was written, its author was evidently so intent on the taxes on the accumulated profits that he overlooked the fact that Congress said "upon or with respect to" the profits.

We think that the words "upon or with respect to" were carefully chosen so as to show that they did not establish a mathematical relation. The words were intended to be words of reference rather than of multiplication, particularly when we regard the fact that the earnings of prior years may be included in the dividends distributed. The purpose of words is to identify the tax in terms of the source of the distribution (year of earnings), not to limit the credit for the taxes. The limitation is accomplished by the individual method of the proviso. If Congress had intended any further limitation, it would have included it in the proviso and not left the matter to the Government's argument of construction, with the curious result, among others, that its definition of "accumulated profits" is made immaterial.

This is also an answer to the Government's argument (Br. 12-15) based upon a comparison of the phrase "taxes paid . . . upon or with respect to such accumulated profits," in the first part of section 131(f), and the phrase "upon or with respect to such [total] profits or income," in the definition of "accumulated profits." The apparent contrast between these phrases disappears once it is recognized that "upon or with respect to," used in each, is not a rigid sign of multiplication but was merely intended to be a reference to or identification of a general source of the tax. The foreign tax is paid "upon or with respect to" the total profits. It is not paid on the total profits at all, as we have shown in our principal brief (pp. 24-26), because of the different basis on which the foreign tax is laid. The foreign tax is also paid "upon or with respect to" the accumulated profits. This is in accordance with the usual use of the terms as we showed at p. 26 of our main brief. Congress conveniently used the latter phrase in the first

part of section 131(f) because it wanted to show that the taxes in question might have been paid with respect to profits accumulated in earlier years. This purpose explains the use of the phrase, and gives full effect to the language without leading to the conclusion that Congress intended to require the Government's formula.

3. The Government's brief plays down as much as possible the very explicit and detailed demonstration of the actual intention of Congress afforded by the illustration read to the Senate by Senator Smoot. See p. 18 of our main brief. This was no inadvertent nor extemporaneous statement. The immediately preceding words of Senator Smoot were: "The explanation of the amendment continues:". See p. 77 of our main brief. The Government says (Br. 8) that Senator Smoot's example was an "illustration of a different point than is here at issue." This seems obviously unfounded. The illustration is clearly a specific example on the very question here at issue, although it also involved the question of a partial distribution of the accumulated profits.

4. The Government repeatedly talks about the accumulated profits bearing "their share of the total foreign taxes and no more." (Br. 12.) The fact is that the foreign tax is measured by the foreign income by foreign standards. The burden of the foreign tax is actually borne by the beneficial owner of the foreign income. The purpose of Congress in enacting section 131(f) was, we submit, to give that beneficial owner credit for the taxes actually paid to the foreign government in the process of accumulating the profits which could be brought in as dividends. The same argument applies to the involved illustrations in the Government's Appendix B (Br. 46-52). For example, on p. 48, it talks of the parent receiving 60 percent of the subsidiary's total 1920 earnings, and therefore being entitled to credit for only 60 percent of the total 1920 taxes. But the fact is, by the very terms of the example (see bottom of Br. 46), that the parent owns 80 percent of the subsidi-

ary's stock. Accordingly, it owned 80 percent of the subsidiary's earnings, it got 80 percent of the accumulated profits as a dividend, and it should therefore be treated as having paid 80 percent of the taxes imposed by Canada as the price of accumulating the profits. On the Government's theory, although the parent received 80 percent of the subsidiary's accumulated profits, it is treated as having paid only 60 percent of the taxes which had to be paid to accumulate those profits. If the parent had owned all the stock of the subsidiary, it would receive all of the accumulated profits and should be treated as having paid all the taxes.

In these illustrations and elsewhere the Government talks consistently of an "over-credit," by which it apparently means a greater credit than the Commissioner would allow.¹ We contend that Congress intended to allow as a credit the foreign taxes actually paid by a subsidiary in the process of producing income. On our theory, there is no over-credit, because, by the proviso, the credit can never exceed the American tax on the dividend. That is the way Congress chose to prevent the happening of an over-credit. On the Government's theory, there is always an under-credit; the credit can never equal the tax actually paid to the foreign government, but must always fall short of it, because of the fraction interpolated into the Government's formula.

5. On page 32 of its brief, the Government treats a statement of Senator Smoot as establishing that the credit can never be obtained for the whole amount of the foreign tax. When the statement is examined in its context (see p. 77 of our main brief), it appears clearly that the Senator was dealing with the situation advanced by Senator Pomerene, where only a part of the accumulated profits of the sub-

¹ This is confirmed by the extraordinary last paragraph of footnote 8, near the bottom of p. 20 of the Government's brief. This paragraph seems to be based upon the premise that anyone who litigates a case against the Government necessarily is seeking something to which he is not entitled.

• subsidiary were distributed as dividends. The context clearly shows that the Government's interpretation of the Senator's language (Br. 32, following the quotation of the language) is erroneous.

6. In footnote 18 on p. 26, the Government cites this Court's recent decision in *Magruder v. Washington, Baltimore and Annapolis Realty Co.*, No. 601, October Term, 1941. But this case, as this Court clearly said (p. 3 of slip decision), involved "a contemporary and long standing administrative interpretation." In the present case, the contemporary construction, long continued, supports the petitioner. Moreover, the case cited involved a general concept in the statute—"carrying on or doing business"—and not a specific provision with a strikingly clear legislative history such as that present here.

Respectfully submitted,

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